European Union

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# Some Recent Decisions of the European Court of Human Rights on Tax Matters – October 2013

**In this note, the author examines recent decisions of the ECtHR relating to human rights and taxation including cases on the imposition of an excessively high tax rate on severance payments, a case wherein a taxpayer's property was unlawfully sold to satisfy a tax debt of a mere EUR 780 and a decision regarding claims of the YUKOS company and its former owners that revolve around their treatment and charges related to alleged tax evasion.**

## 1. An Excessively High Tax (Again!)

It seems that cases on excessively high taxes are like London buses: you wait 40 years and then three of them come along at the same time. In the previous article in this series on Recent Decisions of the European Court of Human Rights (ECtHR or Court),[1] the case of *NKM v. Hungary* (2013)[2] was discussed. Subsequently, there have been two other reported cases both concluding that the same Hungarian tax was excessively high. These are the cases of *Gáll v. Hungary* (2013)[3] and *R.Sz. v. Hungary* (2013).[4] Both of these cases also concerned the 98% tax on the top slice of severance payments to retiring civil servants or government-funded employees, which was the same tax at issue in *NKM v. Hungary*. In both cases, the tax was found to be disproportionate and excessive and to breach Article 1 of the First Protocol (right to enjoyment of possessions). There are slight differences to each of these three cases that are worth noting.

In the *Gáll v. Hungary* case, the retired civil servant was liable to tax at 98% on that part of the severance payment that exceeded HUF 3.5 million. This resulted in an average tax burden of 60% on the entire severance payment (as opposed to 52% in the case of *NKM v. Hungary*). Once again, the ECtHR went through the history of constitutional challenges to the legislation but also added an interesting comparative law section on excessively high taxes from Germany, France, Switzerland and the United States. The Court then concluded that the right to the severance payment was a "possession", and that the taxation involved an interference with the right protected by article 1 of the First Protocol to the European Convention on Human Rights (ECHR or "the Convention"). Interestingly, the Court commented particularly on the retroactive operation of the tax measure and stated the following:[5]

> It is convenient to point out that retroactive taxation can be applicable essentially to remedy technical deficiencies of the law, in particular where the measure is ultimately justified by public-interest considerations.

The Court noted that there had been no deficiency of the law in this case, though that of itself did not appear to be sufficient grounds to find a breach of article 1.

The ECtHR examined the interference with the enjoyment of possession on grounds of proportionality, and concluded that the 98% tax rate entailed an excessive and individual burden on the taxpayer. This was particularly the case since the resulting tax was more than three times the normal tax rate (which was 16%). Interestingly, the Court made the explicit observation that this rate of tax was considerably higher than the rate in force when the right to the severance payment accrued to the taxpayer. In the light of the much higher tax rate, the Court concluded that the tax was not reasonably proportionate to the aim sought to be realized.

The former civil servant had also brought a separate claim based upon discrimination contrary to article 14 (in conjunction with article 1 of the First Protocol) on the grounds that the tax was directed only at former civil servants. In the light of its finding under article 1, the Court found that there was no need for a separate consideration under article 14.

The taxpayer had claimed by way of damages the tax payable under the 98% tax regime. This amounted to some EUR 13,000. In addition, the taxpayer had claimed EUR 3,400 in respect of non-pecuniary damage. The Court concluded that, as the income would normally have been subject to personal income taxation, it was appropriate to award EUR 16,000 in respect of pecuniary and non-pecuniary damage combined. In practice, therefore, the taxpayer received by way of compensation the difference between the 16% tax rate and the 98% tax rate. More interestingly, and in contrast to the *NKM v. Hungary* case, the taxpayer only claimed EUR 900 for costs and expenses incurred by his lawyer. The Court awarded this in full, so

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1. P. Baker, *Some Recent Decisions of the European Court of Human Rights on Tax Matters – June 2013*, 53 Eur. Taxn. 8, p. 393 (2013), Journals IBFD.
2. HU: ECtHR, 14 May 2013, Application No. 66529/11, *NKM v. Hungary*.
3. HU: ECtHR, 25 June 2013, Application No. 49570/11, *Gáll v. Hungary*.
4. HU: ECtHR, 2 July 2013, Application No. 41838/11, *R.Sz. v. Hungary*.
5. Id., at para. 50.

that the taxpayer was fully compensated (unlike the taxpayer in *NKM v. Hungary*).

In the third case, *R.Sz. v. Hungary*, the applicant had been employed by a state-owned company for some 11 years. When his employment was terminated by mutual agreement, his severance pay was taxed at 98% in excess of HUF 3.5 million. The amount in excess was approximately EUR 27,600 and the tax imposed on this was EUR 27,000. The Court applied a similar analysis as in the previous two cases, but without making the specific comparison with the general tax rate of 16% applicable to other taxpayers on other income. The Court concluded that the tax measure entailed an excessive and individual burden on the applicant, particularly given that it targeted a particular group of individuals who were being paid out of the public purse. There was, therefore, a violation of article 1 of the First Protocol.

The taxpayer also brought claims under article 13 (lack of an effective remedy) and article 14 (discrimination), but the Court found that it was unnecessary to examine these separately. Once again, the Court awarded the taxpayer EUR 25,000 in pecuniary and non-pecuniary damage (effectively compensating for the difference between the 16% tax rate and the 98% tax rate) and also awarded the full amount of costs claimed by the taxpayer's lawyer (EUR 3,400 in this case).

While there are slightly different features in each of the three cases, they display a common approach. In none of the cases was the 98% tax an automatic breach of the Convention *per se*. However, having compared this tax rate and the normal tax rate applicable on other income to other taxpayers, together with the retroactive element, and the fact that this high rate was only targeted at certain taxpayers, all these factors combined to a conclusion that the tax imposed an excessive and individual burden on the individuals concerned.

It is hard to draw from this case a general conclusion that a high tax rate – in excess of 50%, for example, – would of itself constitute a breach of the Convention. However, such a high rate combined with other factors could demonstrate a lack of balance between the interests of the individual concerned and that of society in general. Those additional factors meant that the excessively high tax rate constituted an individual and excessive burden.

## 2. Unlawful Enforcement Actions

The factual background to the case of *Rousk v. Sweden*[6] is all too familiar. The taxpayer was the owner of a close company and required to submit a special income tax return. He failed to do so; he fell ill; he suffered from depression; appeals were not lodged in time; eventually the tax debt was passed to the Enforcement Authority for collection. This was where matters appear to have gone wrong. The taxpayer owned a house that was perhaps worth up to SEK 2.15 million on which there was a mortgage of SEK 960,000. At the time of the public auction of his house, the amount of tax outstanding was SEK 6,721. The tax office had, in fact, agreed to a respite in collection but had failed to inform the Enforcement Authority. The consequence was the house was put up for sale at public auction and was sold for the highest bid of SEK 1.6 million. Subsequently, the taxpayer was evicted from the house. Various items of property were thrown away or destroyed in the eviction. The taxpayer's cat was taken to a cattery, and his car was taken to a pound. The taxpayer brought an action alleging breaches of article 1 of the First Protocol and of article 8 (right to respect for private and family life).

Interestingly, the Swedish authorities offered the taxpayer EUR 80,000 by way of compensation, and stated that they regretted the inconvenience caused by the sale of the property at public auction and the ensuing eviction. However, the taxpayer rejected that offer, and the Court decided that the case should not be struck out since the Swedish government had not admitted that there had been a violation of the Convention. It was appropriate, therefore, to continue to determine the case.

The Court first concluded that the sale of the property at public auction and the ensuing eviction for a debt that amounted to only SEK 6,721 (approximately EUR 780) imposed an individual and excessive burden on the applicant. They noted, in particular, that it was not unreasonable to expect the tax office to keep the Enforcement Authority informed of a respite in collection of the tax.

Given that the Court had found a violation of article 1, it might have been unnecessary to go on to consider article 8. However, the Court considered that a separate consideration was necessary, and had some interesting comments to make. In particular, the Court held that the loss of an individual's home is a most extreme form of interference with the right to the respect for the home. The court said as follows:[7]

> […] while the Court accepts that it will sometimes be necessary for the State to attach and sell property, including an individual's home, in order to secure the payment of taxes due to the State through enforceable debts, it emphasises that these measures must be enforced in a manner which ensures that the individual's right to his or her home is properly considered and protected.

The Court then concluded that the auction and eviction, particularly having regard to the fact that there was a lack of procedural safeguards for the applicant to prevent the auction, constituted a violation of article 8.

In terms of damages, the Court assessed that the value of the house was likely to have been SEK 2 million but it was sold for SEK 1.6 million. It, therefore, awarded the difference of SEK 400,000 as compensation. Having regard to all the other costs incurred, the Court awarded by way of pecuniary damages the sum of EUR 65,000. To this the Court added EUR 15,000 for non-pecuniary damage (interestingly, making the figure of EUR 80,000 that the government had originally offered). The taxpayer had also claimed approximately EUR 8,400 as legal expenses and was awarded EUR 8,300.

6. SE: ECtHR, 25 July 2013, Application No. 27183/04, *Rousk v. Sweden*.

7. Id., at para. 138.

There are a number of unique features in this case: the small amount of the tax debt and the clear disproportionality between the value of the house and the amount of the tax debt; the failure of the tax office and the Enforcement Authority to keep one another informed; the damage caused during the eviction. Nevertheless, it is interesting to see an example of actions taken to enforce a tax debt being challenged successfully on grounds of breach of the Convention.

### 3. More on YUKOS (and Its Owners)

The claims brought by the YUKOS company and its former owners against the Russian Federation before the European Court of Human Rights have already been featured in this series of articles.[8] In *Khodorkovskiy and Lebedev v. Russia*[9] the former head and major shareholder of YUKOS plc and one of his major business partners complained of their treatment and the criminal charges brought against them arising out of, inter alia, alleged tax evasion. Their complaints raised a series of issues, ranging from their treatment when on trial, through to their prison conditions and, above all, the political motivation behind the charges brought against them. A number of the allegations were found to be proved, and several others – including the allegation of political motivation – were not substantiated.

From the point of view of technical, tax-related issues, there are probably two aspects of the case that are most interesting.

First, the applicants were charged with tax evasion based upon an entirely novel allegation: no one had previously been charged with an allegation in Russia in connection with the sale of oil through the internal, low-tax localities. They complained of a breach of the principle that no one should be charged with a criminal offence that did not exist at the time of their conduct (article 7 of the Convention – the principal of *nullum crimen sine lege*). The Court dismissed[10] these complaints on the grounds that concepts such as tax evasion were subject to development, and would need to be applied to new circumstances not previously considered.

On a second, substantive, allegation the applicants were more successful. They complained that they had been directly assessed as directors of companies for unpaid taxes due from the companies, when there was no law providing for such liability. The Court held [11] that the imposition of personal liability on directors was a breach of their right to enjoyment of their possessions, contrary to article 1 of the First Protocol.

Overall, the Court awarded the applicants EUR 10,000 in respect of non-pecuniary damage. Both remain in prison in Russia.

8. *See* P. Baker, *Some Recent Cases from the European Court of Human Rights*, 49 Eur. Taxn. 6, pp. 326-327 (2009), Journals IBFD.
9. RU: ECtHR, 25 July 2013, Application No. 11082/06, *Khodorkovskiy and Lebedev v. Russia*.
10. Id., at paras. 745 to 821.
11. Id., at paras. 852 to 885.



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